DOW THEORY LETTERS INC.

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36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

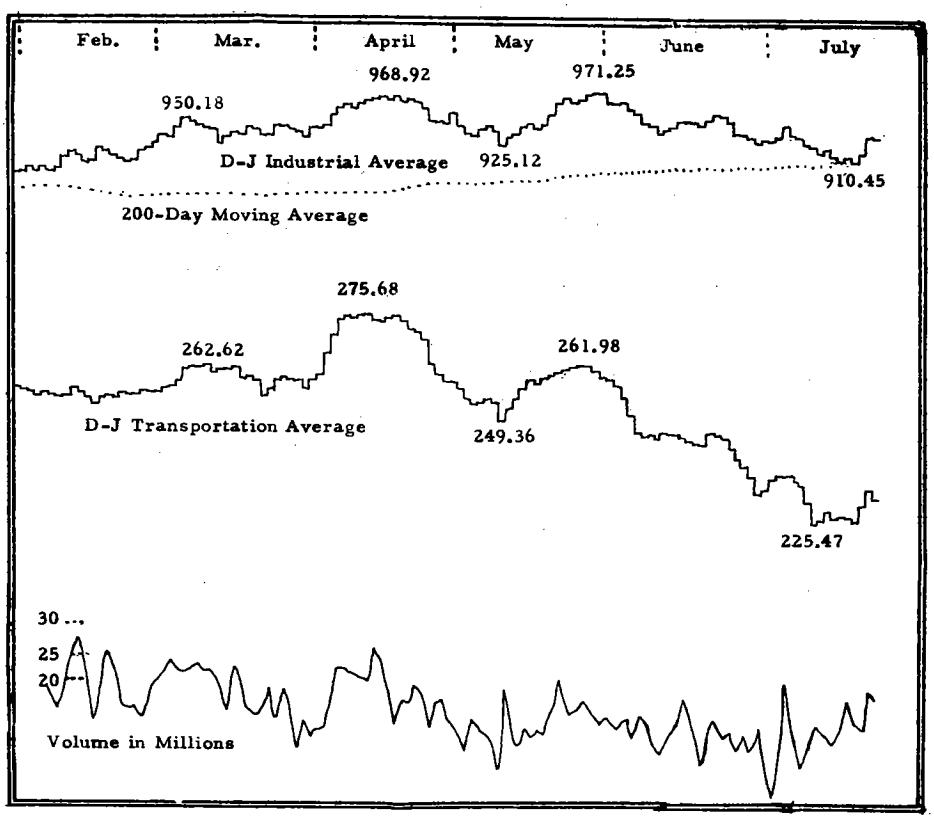
July 28, 1972 Letter 536

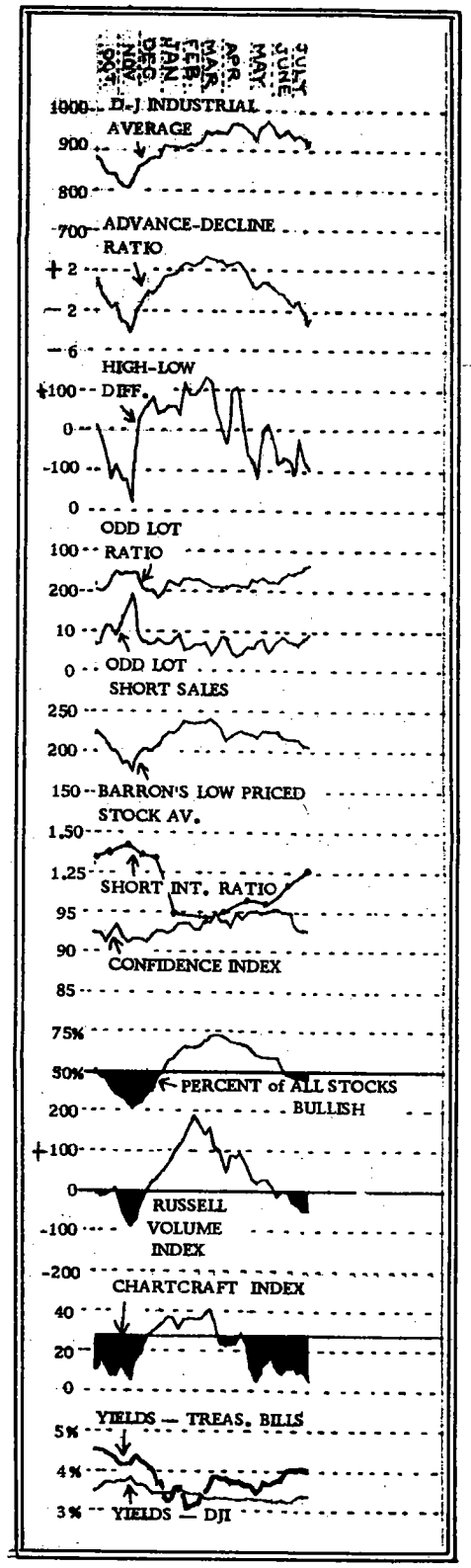
THE MARKET: It has been said that the difference between men and boys is that "men have more expensive toys." In view of this, I was most interested in the latest report from my good friend Harry Schultz, in which he explains the popular European children's game, "der schwarze Peter." In this card game the jack of spades passes from hand to hand, and the idea is not to get caught with it at game's end.

Schultz then describes an international monetary game of der schwarze Peter in which the jack of spades is the US dollar. He pictures Uncle Sam as the owner of the "big casino," dealing out the cards (dollars) in a grim session in which the players (the major trading nations) try to shovel off jack of spade dollars to each other. The last player, Japan, suspects that he may get stuck badly, so he goes to the casino to ask the casino boss for a set of fair rules. A burly guard at the casino gate tells him that the boss is out "and he isn't expected back until November, at the earliest." My conclusion: We're all playing the world's most expensive game. That, I presume, is what makes us men, not boys. (Schultz Letter, P.O. Box 45, Rheinfelden 4310, Switzerland).

In the meantime, the stock market has been engaged in its usual pursuit of trying to deceive the crystal ball-gazers and in-and-out traders. And it has been doing a good job of it. A week ago the consensus was that the Dow would plunge obediently to around 890 in "a final three-day selling climax." At that widely advertised juncture, all red-blooded American speculators would assume positions for the coming profitable ride up and over 1000 (to be brought on by a Nixon victory in November).

Glancing at the page 1 chart of the Averages, it can be seen that the script has not gone exactly as planned. On July 12 the Dow closed at 923.69, Transports at 225.47.





From there, despite a sagging Industrial Average, the Transports tended to move upwards. On July 18, Industrials dropped to a new low of 911.72, but Transports would not confirm (Transports held persistently above the July 12 low of 225.47). Two days later, Industrials sank to another low for the move at 910.45 (July 26). Again Transports refused to confirm, holding doggedly above 225.47.

This "mini" non-confirmation on the downside set off a violent rally of over 10 points in the Dow on Friday, July 21. The rally continued on Monday, July 24, with a rise of 15 points in the Dow. By Tuesday, some of the steam was running out of the rise, and it was becoming clear that some downside "testing" would be in order.

Except for the collapse in the advance-decline ratio, there was little to suggest that the market had reached any kind of important base at the recent July 20 lows. Nevertheless, long, dragging, downward movements and violent, periodic rallies are only too familiar to those who have studied the action of the market during primary bear trends. As far as I am concerned, it makes little sense to try to "beat" this deceptive market on each and every rally and decline. The obvious recent picture to me is that the advance-decline line topped out in early 1971, then formed another important but lower top in March of this year. On a longer term basis, Utilities recorded their highs in 1965. And the Dow Industrial Average has never been able to better its 995.15 bull market peak of February, 1966.

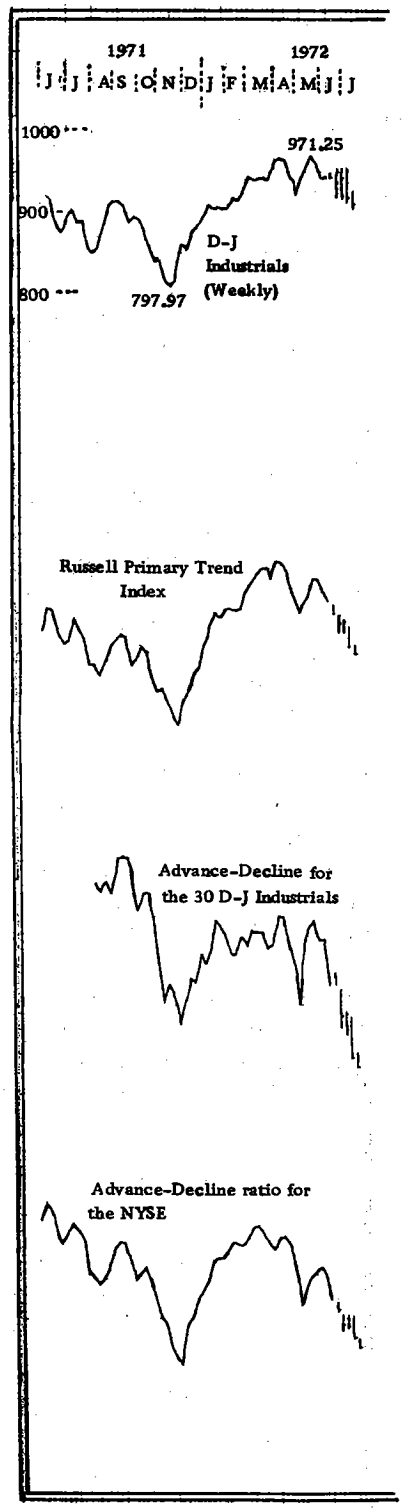
In other words, the stock market (with the exception of the gold shares) has become a most difficult place to make money in. The steady selling pressure which has eroded so many values will probably not cease until a major primary bear market bottom is formed. Such a bottom, it seems, will only occur when the Government runs out of resources to fight the bear, and a subsequent wide-open collapse sends the market down towards its final lows. In a phrase, "we are not there yet."

As an aid to general perspective, I am introducing a new chart in this report. The chart (at right) traces four indicators from May, 1971, to date. All indices are on a weekly basis (high-low ranges are shown for the last five weeks).

The primary trend index (PTI) which was discussed in the last Letter, has now lost <u>over half</u> of all its gains since the 1971 low. I consider that this has bearish long-term implications.

The A-D line for the 30 Dow Industrial stocks (see Letter 529, and I suggest that subscribers keep past Letters for reference) has plunged to the lowest level since the 1970 bottom. Ironically, although the Dow itself has been one of the stronger indicators, the A-D index for the 30 Dow stocks has been about the weakest indicator. This means that the strength in the Dow has been due to a <u>small minority</u> of strong issues, while the majority of the 30 Dow stocks have been in downtrends. I consider this to be a large minus in the technical picture.

Finally, the A-D ratio for the whole NYSE has been very weak, dropping on July 20 to its lowest level since November 29, 1971, at which time the Dow stood at 829.73. It is the A-D ratio which underscores the fact that since second-quarter, 1971, the trend of the majority of stocks has been down.



In all, I consider the technical picture of the market to be poor. The indications are that the Dow Industrial Average has been the "cover" which is providing hope that all will be well on Wall Street between now and the end of 1972. But the three indicators pictured here show that large cracks exist in the market's underlying structure. These same indicators suggest that rallies will probably continue to be led by the single strong indicator, the Industrial Average, while the other indices underscore the probability of profitless trading and the coming major trouble ahead.

<u>MOMENTUM:</u> For me, this is a fascinating picture of the Dow Industrials from the year 1919 to date. The chart (page 3) is drawn to semi-logarithmic (or ratio) scale, so that all movements are shown in percentages. In other words, an advance of 200 to 400 on the Dow shows on this chart as exactly the same vertical distance as an advance from 400 to 800. The percentages in both cases are the same, and the vertical distances for both advances are therefore the same on a semi-logarithmic scale chart.

One of the great advantages and points of interest in a semi-log chart is that trendlines drawn on such a chart portray rates of growth. Thus we see that the extraordinary trendline stretching from the 1932 Dow bottom of 41.22 through the 1942, 1949, 1953, 1962 and 1966 bottoms has measured a steady rate of growth (including inflation, if you like) which has lasted for 37 years.

I have studied the implication of trendlines for many years, and one of the conclusions I have come to is that the longer a trendline holds, the more important the ultimate reversal when it arrives. With this in mind, it is instructive to note that the great 37-year trendline which began in 1932 was reversed in 1969. That meant that after 37 years of a steady rate of ascent, the growth-rate of the Dow Industrials simply ended. The upward momentum had finally come to an end.

The interesting thing about the reversal was that it was not followed by the kind of sudden collapse that might have been expected. In retrospect we now know that the forces which made for the 37-year uptrend, the tremendous growth, productive and inflationary forces, did not and would not reverse in a month or a year. In fact, simultaneously with the breaking of the trendline, the Government fed massive new stimuli into the economy while opening the money gates wide. This, in effect, tended to float the Dow up on a sea of debt, red ink, fiat paper and startling new Governmental spending programs. Obviously, the staggering expenses connected with Vietnam and weapons procurement was no small factor in the Government's effort to keep the economy and the stock market afloat.

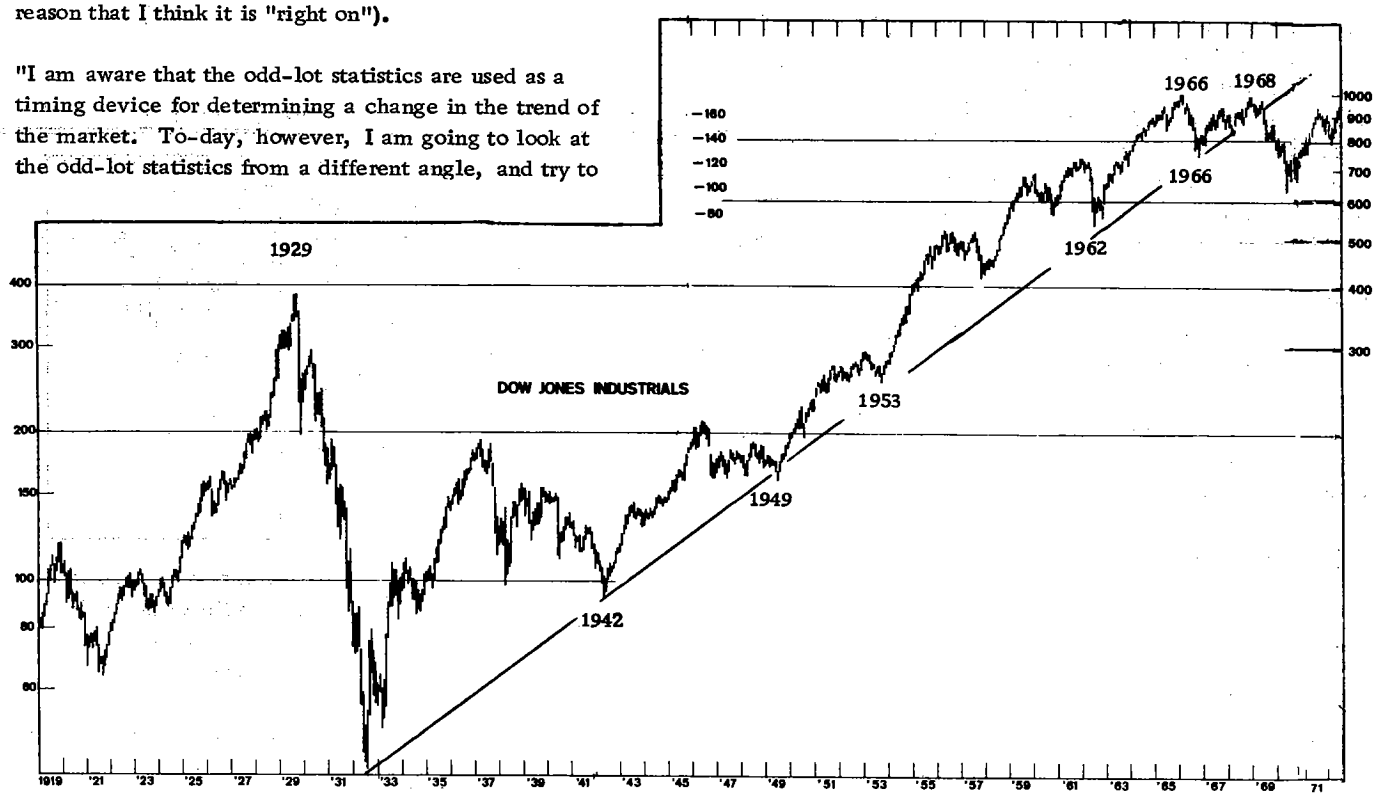
Now, as 1972 enters its second half, it is certainly highly significant that the US dollar is again sinking, our foreign creditors are erecting barriers (exchange controls) against a flood of new dollars past their borders, and that the Presidential opposition to Mr. Nixon (Senator McGovern) has promised, as part of his campaign platform, a whopping reduction in US defense expenditures.

To return to the chart again, it is obvious that the forces which made for the rise from 1932 to 1969 were great, long-lasting and almost irresistable. Whatever the changes and new pressures which caused the rupturing of the trendlines, they too must be of the "earthshaking" variety.

I feel it is too early now to tell the real nature of the new forces which are holding the Dow persistently below the 37-year trendline. But those forces are certainly there, and it has now been three years since the trendline reversal. I would wager that with the 1972 election and its aftermath, we will have some excellent insights into the coming "new face of America."

Coincidentally, after I wrote this piece I received "Market Indicators Digest" by friend Fred Macaskill (PO Box 17389, Johannesburg, SA). Fred included his usual excellent section on the NY market together with the following, on momentum. I am taking the liberty of reprinting it (for the obvious reason that I think it is "right on").

"I am aware that the odd-lot statistics are used as a timing device for determining a change in the trend of the market. To-day, however, I am going to look at the odd-lot statistics from a different angle, and try to

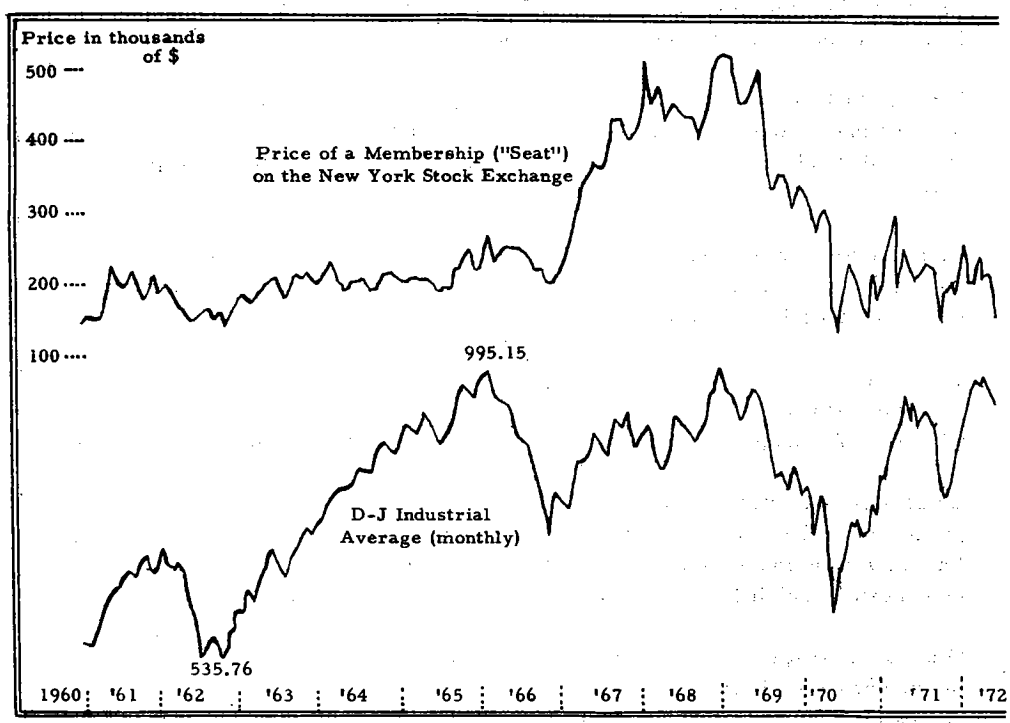


 assign a longer term meaning to them.

"On December 21, 1901, Charles Dow wrote in the Wall Street Journal: 'Momentum is one of the great factors in speculation. Momentum is the result of a conviction impressed upon great numbers of people that the tendency of the market is in a certain direction. Such people, consequently, act in that direction in either the purchase or the sale of stocks. When there has been a bull market for three or four years, the public becomes convinced that the long side is the right side. Hence when stocks decline, the public buys, and this buying, with the help of manipulation, makes frequent rallies even after the tide has fairly turned down.'

"There are two points I wish to discuss in connection with this quotation. Firstly, the bull period has run for 20 years, lasting from 1949 to 1969. The duration and extent of the growth cycle gathered great momentum. At present, 3 years after the turn, this momentum has resulted in the market still being near its peak.

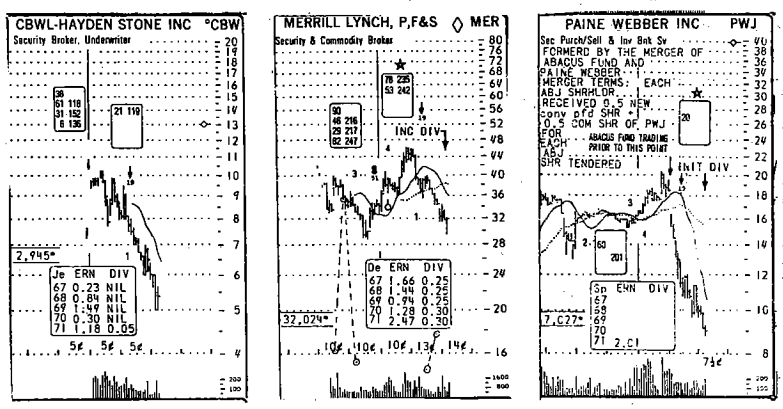
"My second point is that the turn has come and is highlighted by the persistent liquidation by the public, as shown by the odd-lot sales. The next step in the cycle will be that the market will gather downside momentum. Once the primary decline is in full force it will not easily be halted, for its momentum will keep it rolling relentlessly on."



WALL STREET has a thousand explanations for every price movement. But the fact remains, as William Hamilton, the great Dow Theorist, put it in the 1920's, that "Wall Street is inherently bullish. One reason for this is that the financial district does not make money in a bear market, contrary to the ideas of people who think that then is the time when the Street reaps its harvest and wickedly turns disaster to its own advantage. The Street lives on Commission, and not on what it might make by selling short the securities it originates."

I used to use one particular gauge to measure bull market prosperity on Wall Street (or for bear market hard times), and that was the price of a "seat" on the NYSE. As the accompanying chart shows, the price surged to over half a million dollars during 1967-68.

During the 1969-70 collapse, seat prices lost over 70% of their value, dropping below $150 thousand per seat. In early 1971 the price of a seat ran up to just under $300 thousand. That was the high for the move. A week ago a seat sold for $150 thousand, and it is obvious that from the standpoint of this gauge, the bull market party is over.


CBWL-HAYDEN STONE INC °CBW
Security Broker, Underwriter
MERRILL LYNCH, P,F&S ◊ MER
Security & Commodity Broker
PAINE WEBBER INC PWJ

Now we have a second check on Wall Street prosperity - or the lack of it. It is the securities of leading Wall Street brokerage houses. I don't care what the rationale is or why this or that circumstance is different today. I do know that during a primary bull market the profits of the Wall Street houses move up, up, up. I include a chart of some of the listed securities representing major NYSE brokerage firms (charts courtesy of Quote Digest, PO Box 213, Wichita, Kansas 67201). Subscribers may draw their own conclusions.

Actually, I tie this study in with the "Momentum" study in this same mailing. The fact is that after more than three decades of upward momentum (from 1932), after three decades of slowly bringing in the public, the upward momentum has flattened

out and is ready to turn down. Now we see the beginning of the exit of the public. Mutual fund redemptions outpace purchases almost monthly, odd lotters stay consistently on the selling side, the public is finally becoming disillusioned.

This fits in with what is happening to the equities of leading brokerage houses. It fits in with the collapse of seat prices on the NYSE.

GOLD, MONEY, TRADE: In the last few Letters I have been drawing readers' attentions to Europe's new crackdown on the dollar. Europe is having its own business problems, one of which is the invasion of the continent by Japan. The invasion is spearheaded by Japan's well-made, competitively priced merchandise and its driving desire to do business. In view of this, it is clear that at present a general monetary float against the dollar would merely mean that Europe was giving the US a further competitive advantage. As of now, Europe has all the competition she can handle (straw in the wind; for the first time the giant VW works has laid off workers in a production cutback).

But the Europeans are not being caught asleep, and plans are being made for what may soon be the roughest competition the US has seen since Japan first entered the scene. The accompanying news clip tells the story eloquently and dramatically.

Meanwhile, last week 10 finance ministers of the European Economic Community put out a warning to the US, the essence of which was that by next year (or after elections) "equal rights" are going to be the law in the Free World. This statement boils down to two theses: (1) The US is the only nation with an inconvertible currency. The US has almost no money acceptable to its creditors and it will not part with its gold. (2) The US is the only nation which is allowed to run prolonged and chronic deficits. Worse still, the US has been "buying up" Europe with those deficits. Starting next year, the US will have to play by the same rules the other nations play by (implications: The US is the only nation that never willingly deflates to halt inflation. It will have to start).

The barriers against the dollar are being erected, under the leadership of France. The rest of Europe has been following, and the battle is on. No one knows how long the silent war will last (probably until well after election), but the payoff is becoming clear enough. The dollar must become convertible again, and the only question is at what price in relation to gold. Most observers believe that there must be a minimum markup to at least $100 per ounce for gold in order to make any agreement workable and meaningful.

From the credibility standpoint, a number of statistics are going around. The following is an interesting table.

Average Metal Prices	January 31, 1934	June 26, 1972	(increase) % of change
Gold	$35.00 oz.	$63.40	81%
Silver	44.19¢ oz.	$ 1.56	267%
Copper	8.06¢ per lb.	52.5¢	551%
Lead	4.00¢ per lb.	15.5¢	287%
Zinc	4.27¢ per lb.	18¢	343%

Average Price Increase of Silver, Copper, Lead & Zinc..... 362%
Since Jan. 31, 1934

Price of Gold today to equal average price increase of metals shown above... $161.70 per oz.

In a report just received from Bill Tehan of New York (P.R. Herzig & Co.) I note some extremely interesting comments on the gold-monetary situation. Talking about what he terms "Phase 2," Tehan calls this the phase of the dollar glut. Tehan points out that since 1970 the dollar component of the Euro-currency market has boomed from $37.5 billion to $71 billion. This huge, disruptive build-up of dollars has been accompanied by crisis after crisis including the floating of the market, suspension of dollar convertibility, breakdown of the Smithsonian agreements, etc. In such manner, phase 2 ended.

Tehan points out (and this is crucial) that the recent increase in world reserves has been composed almost entirely of dollars which are now unwanted, sinking almost weekly in value and entirely inconvertible. The world's banking system thus

Europeans Create Huge Trade Bloc

Stiff Competition Expected Soon With U.S., Japan

BRUSSELS (UPI) — Western Europe, long divided into two rival trading blocs, merged yesterday into the mightiest single free trade area in the world.

"It's a great day for Europe," exulted Geoffrey Rippon, British minister for European affairs, after the ceremony that brought 15 Western European nations into the free trade bloc.

Rippon and others suggested that the trade area might form the basis for a continent-wide political union.

300 MILLION POPULATION

The free trade area, when it comes into effect next Jan. 1, will embrace 300 million persons and will do a total annual trade of $275 billion — nearly twice as big as that of America, Russia and Japan combined.

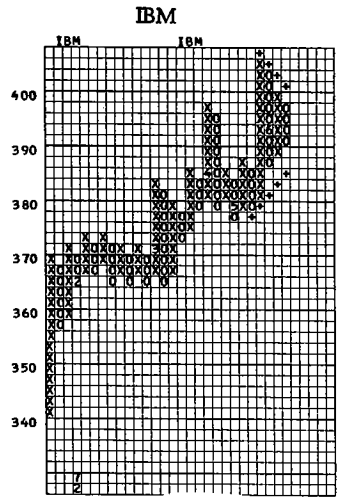
 includes a mass of "flight capital" dollars, unstable, decreasing in value as gold rises in price, and ready to run.

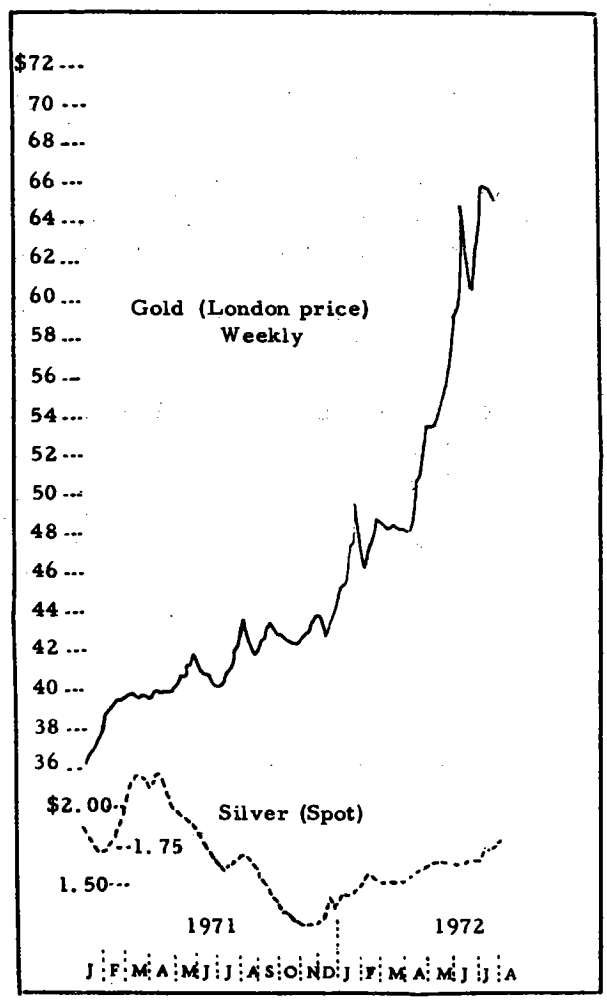
We are now in phase 2. Tehan sees all currencies as currently overpriced, he sees world economies now deteriorating, and he sees exchange controls putting the brakes on international business. The effects could be a downward float of all currencies as nations seek to improve their balance-of-payments, a rise in interest rates as nations seek to protect their currencies, a crisis in the Euro-currency market, and a rise in the price of gold "to several times current price levels."

In the meantime, I (being a market-oriented type) continue to scrutinize the price fluctuations in the price of gold itself. Theories can be excellent, crystal balls can be polished and in working order, analysts can be brilliant, but the price of gold represents the sum total of all the thinking on monetary matters. Verdict so far — the monetary problems have not begun to be solved. The price of gold (see page 6 chart) remains near its all-time high. All corrections (even though a large one would now be warranted on purely technical grounds) are held to minimum proportions. So far, "someone" is buying all the gold that is being offered — at or near the highs.

GOLD-SILVER: As this is written, gold is quoted in London at $65.75, almost at a new historic high. Silver is showing more strength than any time since early 1971. Volume in trading on gold shares is drying up to extreme levels. Such a decrease in volume suggests an absence of stock for sale. This could be the forerunner of a new upmove in gold, and the move could be set off by a rise in the price of gold bullion into the $68 to $70 level or beyond.

KEY STOCK: One of the key stocks in the market is giant IBM, a stock which is heavily weighted in the Standard & Poor Averages. I have been watching IBM to see if it is ready to give any bellwether signals. A rise to 404 would put IBM above the point & figure trendline (see accompanying chart) and constitute a bullish omen for the market. Conversely, a drop to 384 would crack the rising (bullish) trendline and provide a bearish signal for IBM and the whole market. So far, the S & P Industrial Average and S & P 500 have refused to crack their May lows (although the Dow has). I would guess that if IBM dropped into the 384 area the S & P Averages would almost certainly head down through their May lows. (Chart courtesy of Chartcraft, Larchmont, NY 10538).





THOUGHTS: The response I received from the thought piece in Letter 533 was most interesting. People from all over the world wrote to me, and (this really surprised me) almost all of the comment was good. Maybe those who didn't like it simply spared me their opinions. At any rate, I want to write a little more.

I have been thinking alot about the three hardest yet most important questions. Who am I? What am I doing here? Where am I going? I have come to a conclusion about one area. That is that I believe our basic purpose on this earth is to advance. Why advance? The answer is, so that we can move towards our highest potential and so that we can help others to do the same. Along these lines, I now feel that almost nothing that happens is random, almost nothing that happens is a "mistake." Everything is put in our path to aid our advancement. There exist only two alternatives, to take advantage of the opportunities to advance or to ignore them.

Since the vast majority of mankind lives purposeless lives, they obviously are not thinking in terms of advancing. Yet a small minority is moving "upwards," and I literally know that a great majority of my readers fall into the "advancing" category. How do I know this. Nothing but intuition. I cannot prove it, but I trust my intuition above all.

Final question: How do we advance? I have no answer, I am still working on this question for myself. Yet, I know it can be done. It is the questions which are important, not the answers. Ask the right questions and you will advance. Search for the "answers" and you may waste your life. I have found that most people, if they do anything, concern themselves with answers. This is passive. If they find "the right answers" they feel they can rest, collapse, be dead, retire. Searching for the right questions is active, it is scary, it takes you to new places, it shakes your world.